

DRAFT



**STATE BOARD OF EQUALIZATION  
STAFF LEGISLATIVE BILL ANALYSIS**

Date Introduced:	<b>02/16/99</b>	Bill No:	<b>AB 464</b>
Tax:	<b>Sales and Use, Special Taxes and Fees</b>	Author:	<b>Maldonado</b>
Board Position:	<b>Board-sponsored</b>	Related Bills:	

**BILL SUMMARY:**

This bill would revise the interest calculation provisions in the tax and fee programs the Board administers so that the same rate of interest is applied to both underpayments and overpayments of tax.

**ANALYSIS:**

Current Law:

Under existing law, persons who are late in payment of their tax obligations are required to pay a penalty of 10 percent of the tax, plus interest on the unpaid tax from the date the tax was due to the date upon which it was paid. Persons who have overpaid their tax to the state are granted credit interest on the overpayment (when it is determined that the overpayment was not intentional or a result of carelessness) from the first day of the calendar month following the month during which the overpayment was made to the last day of the month following the date upon which the refund is approved by the Board.

Prior to July 1, 1991, there was no difference between the rate of interest paid by the Board to taxpayers on overpayments of tax and the rate of interest paid by taxpayers to the Board on underpayments of tax. However, AB 2181 and SB 179 ( Chs. 85 and 88, respectively) significantly changed the computation of *credit* interest on overpayments of tax. Those measures provided that interest on underpayments is calculated based on specified provisions of the Internal Revenue Code, plus three percentage points. This rate is currently set at 11 percent. Interest on overpayments of tax is based on the bond equivalent rate of 13-week treasury bills auctioned. That rate is currently set at 5 percent. Therefore, under current law, there is currently a 6 percent difference in the rate of interest paid on overpayments and the rate of interest assessed on underpayments.

Proposed Law:

This bill would amend Sections 6591.5 of the Sales and Use Tax Law to require that interest paid with respect to both underpayments and overpayments of tax be calculated at the modified adjusted rate per annum determined by specified provisions of the Internal Revenue Code plus three percentage points. Since the various Special

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Taxes and Fees laws currently reference Section 6591.5, the interest on both underpayments and overpayments of tax or fees under the Special Taxes and Fees programs administered by the Board would also be calculated in accordance with the provisions of this bill.

This bill would additionally amend Section 6907 of the Sales and Use Tax Law to require that interest on any overpayment of sales or use tax be paid from the last day of the month following the quarterly period for which the overpayment was made. In addition, the bill would specify that no refund or credit shall be made of any interest imposed with respect to the amount being refunded or credited.

The bill would become effective January 1, 2000.

Background:

The July 1, 1991 legislation that revised the method of computing interest was proposed by the Department of Finance as part of the Governor's package to resolve the budget deficit. This legislation was prompted by a 1990 landmark decision involving new sales and use tax issues for U. S. Government contractors in California. As a result of that decision, U.S. Government contractors would be entitled to refunds of overpayments of taxes previously paid to the Board on specified transactions with the U. S. Government. Because of the potentially significant amount of tax and the period of time the overpayments occurred, it was recognized that these refunds would include a very significant amount of credit interest. With the reduced rate of interest, naturally, the state would not lose such a significant amount of revenue.

Similar bills have been introduced in the past: AB 2972 (Mays, 1992 Legislative Session), AB 2083 (Takasugi, 1993 Legislative Session), AB 3487 (Andal, 1994 Legislative Session), AB 1189 (Takasugi, 1995 Legislative Session), and AB 222 (Takasugi, 1997-98 Legislative Session).

AB 222 was amended early in 1998 to instead provide for a one percent increase in the credit interest rate, and, with that amendment, was held in the Senate Appropriations Committee. AB 2083 and AB 3487 both failed passage in the Assembly Revenue and Taxation Committee; and AB 1189 failed passage in the Senate Appropriations Committee. AB 2972 passed the Legislature, but was vetoed by the Governor. In his veto message, Governor Wilson stated, "Legislation enacted last year (Chapter 85, Statutes of 1991) established a separate, lower rate for state and local sales tax refund liability. Chapter 85 was enacted to minimize the impact of accruing interest as a result of the Aerospace decision. This bill would reverse that legislation, thereby reinstating the higher rate on refund liability.

"Imposing a lower rate for refunds minimizes the impact on the state in the event of large taxpayer refund liability. Imposing a higher rate on amounts owed by taxpayers serves as an incentive for taxpayers to remit those amounts in a timely manner as well as to comply with the law. I do not wish to change these incentives."

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**COMMENTS:**

1. **Purpose of bill.** This is a Board-sponsored measure to eliminate the 6-point disparity that currently exists in the rate of interest charged on late payments and the rate of interest paid on refunds. Since the interest on U.S. government contractor refunds has been settled upon, it seems logical and equitable to reestablish prior law and equalize the interest rates between refunds and liabilities. This would address the concerns of many taxpayers who view this disparity as extremely unfair.
2. **Other major taxing agencies don't have such a disparity.** According to the Franchise Tax Board, its interest rate on both underpayments and overpayments is the same--currently, 7 percent compounded daily. The Internal Revenue Service has only a 1 point disparity in interest rates for corporations – currently, 7 percent is compounded daily on underpayments and 6 percent on overpayments, and no disparity for noncorporate taxpayers.
3. **This bill would not change interest charged on late payments of taxes.** The Governor's veto message on AB 2972 (referred to above) indicates that interest provides an incentive to pay as well as to comply with the law and that he does not want to change these incentives. This bill would not change the rate of interest charged on late payments of tax. It is only intended, and will only change, the interest rate paid on overpayments. Therefore, the incentives provided in the law to encourage prompt payment of taxes would remain intact and would not be affected by the enactment of this measure.

**COST ESTIMATE:**

One-time administrative costs, preliminarily estimated to be \$19,000, would be incurred. These costs would be attributable to programming for the proposed change in the interest calculation date (the bill requires the computation of credit interest to start from the last day of the month following the quarterly period for which the overpayment was made rather than the first day of the month following the month during which the overpayment was made).

**REVENUE ESTIMATE:**

(See table on the following page)

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**Increased Credit Interest Payments  
at an 11% Rate**

Year	State Tax			Local Tax	Transit Tax	Total
	Special Taxes	Sales & Use Tax	Subtotal			
2000-01	75,050	552,399	627,449	248,580	74,021	950,050
2001-02	536,071	3,945,707	4,481,779	1,775,568	528,725	6,786,071
2002-03	1,050,700	7,733,586	8,784,286	3,480,114	1,036,301	13,300,700
2003-04	1,565,329	11,521,465	13,086,793	5,184,659	1,543,876	19,815,329
2004-05	1,801,200	13,257,576	15,058,776	5,965,909	1,776,515	22,801,200

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